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## **FEDERAL HOUSING FINANCE AGENCY**

**[No. 2012-N-13]**

### **State-Level Guarantee Fee Pricing**

**AGENCY:** Federal Housing Finance Agency.

**ACTION:** Notice; input accepted.

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The Federal Housing Finance Agency (FHFA) oversees the operations of Fannie Mae and Freddie Mac (“the Enterprises”). The Enterprises are in conservatorships, and, as Conservator, FHFA has statutory obligations in its conduct of the conservatorships, including preserving and conserving assets. Though the Enterprises are congressionally chartered and federally supervised and regulated, state laws and practices can have a significant impact on their loan default costs.

This Notice sets forth an approach to adjust the guarantee fees (“g-fees”) that the Enterprises charge for mortgages that finance properties with one to four units (“single-family mortgages”) in certain states to recover a portion of the exceptionally high costs that the Enterprises incur in cases of mortgage default in those states.

### **Background**

The Enterprises charge g-fees to compensate for the credit risks they undertake when they own or guarantee mortgages. The g-fees the Enterprises currently charge on single-family mortgages vary with the type of loan product and with loan and borrower attributes that affect credit risk. FHFA has a responsibility to ensure that those fees are

proper and adequate. The single-family g-fees that the Enterprises charged prior to conservatorship proved inadequate to compensate for the level of actual credit losses they experienced. This contributed directly to substantial financial support being provided to the two companies by taxpayers.

G-fee payments to Fannie Mae and Freddie Mac generally include both ongoing monthly payments and an upfront payment at the time of Enterprise loan acquisition.

Current Enterprise schedules for upfront g-fees may be found at

<https://www.efanniemae.com/sf/refmaterials/llpa/pdf/llpamatrix.pdf> and

<http://www.freddiemac.com/singlefamily/pdf/ex19.pdf>.

Recent experience has shown a wide variation among states in the costs that the Enterprises incur from mortgage defaults. This is due, in large part, to differences among the states and territories in the requirements for lenders or other investors to manage a default, foreclose, and obtain marketable title to the property backing a single-family mortgage. Foreclosure takes longer than average in some states as a result of regulatory or judicial actions. Further, in some states the investor cannot market a property for a period after foreclosure is complete. There is also variation among the states in the per-day carrying costs that investors incur during the periods when a defaulted loan is non-performing and, in some states, when a foreclosed property cannot be marketed. Those variations in time periods and per-day carrying costs interact to contribute to state-level differences in the average total carrying cost to investors of addressing a loan default. Because the Enterprises currently set their g-fees nationally, accounting for expected default costs only in the aggregate, borrowers in states with lower default-related carrying costs are effectively subsidizing borrowers in states with higher costs.

The principal drivers of differences across states in the average total carrying costs to the Enterprises of a defaulted single-family mortgage are, in order of importance—

1. the length of time needed to secure marketable title to the property;
2. property taxes that must be paid until marketable title is secured; and
3. legal and operational expenses during that period.

There is a wide variation among states in all three of those variables.

In light of these cost differentials, FHFA's March 2012 Conservatorship Scorecard set forth the objective for Fannie Mae and Freddie Mac of developing appropriate risk-based guarantee fee pricing by state. FHFA's proposal described here would adjust the upfront fees that the Enterprises charge when they acquire single-family mortgages in states where Enterprise costs that are related to state foreclosure practices are statistically higher than the national average. The size of the adjustments would reflect differences in costs in those states from the average.

FHFA recognizes that the data the Enterprises have used to calculate state-level cost differences in this proposal are based on a combination of Enterprise experience and estimation. Actual costs incurred by the Enterprises in the future may vary over time and among individual defaults within a state. Because of this variability, FHFA's planned approach focuses on five states that are clear outliers among states in terms of their default-related costs.

This document outlines the approach that FHFA is considering and discusses potential additions and changes to the calculation of such fees in the future. Through this Notice, FHFA is providing an opportunity for public input on these subjects. After

reviewing the public input and determining a final state-level guarantee fee pricing method, FHFA expects to direct the Enterprises to implement the pricing adjustments in 2013.

### **Approach to State-Level G-Fee Adjustments**

The approach set forth in this Notice is based on Enterprise experience and does not include the forward-looking impact of recently-enacted state and local laws that may increase the Enterprises' costs. FHFA intends to periodically reassess state-level pricing based on updated Enterprise data. The agency may include the impact of newly-enacted laws if they clearly affect foreclosure timelines or costs, where such costs may be reasonably estimated based on relevant experience.

FHFA's approach would focus on the small number of states that have average total carrying costs that significantly exceed the national average and, therefore, impose the greatest costs on Fannie Mae, Freddie Mac, and taxpayers. Mortgages originated in these highest-cost states would have an upfront fee of between 15 and 30 basis points, which would be charged to lenders as a one-time upfront payment on each loan acquired by the Enterprises after implementation. Based on current data as described below, those five states are Connecticut, Florida, Illinois, New Jersey, and New York.

Lenders may pass an upfront fee through to a borrower as an adjustment to the interest rate on the borrower's loan. Because the upfront fee is paid only once, its impact on the annual interest rate is much smaller than the upfront fee itself. Dividing the upfront fee by five provides an approximation of the potential impact on the interest rate. To illustrate, a 15 basis point upfront fee, if fully passed through by the lender, would be roughly equivalent to an increase in the annual interest rate of three basis points. Under

FHFA's planned approach, a homeowner in an affected state obtaining a 30-year, fixed-rate mortgage of \$200,000 could see an increase of approximately \$3.50 to \$7.00 in his or her monthly mortgage payment, reflecting a range of upfront fee adjustments of 15 to 30 basis points.

The methodology used by the agency to develop the planned approach addresses only differences in the expected cost of defaults associated with single-family mortgages that will be acquired by the Enterprises in the future and are underwritten according to current standards. If FHFA had developed an approach using information on the realized default losses on loans the Enterprises acquired in the past decade, which were originated under less stringent underwriting guidelines, the increases in upfront fees in the states affected would be significantly greater, because recently acquired mortgages are expected to default at lower rates due to strengthened underwriting standards.

#### Methodology

The methodology used to develop the planned approach to state-level g-fee pricing relies on three key factors. The first is the expected number of days that it takes an Enterprise to foreclose and obtain marketable title to the collateral backing a mortgage in a particular state. The second is the average per-day carrying cost that the Enterprises incur in that state. The third is the expected national average default rate on single-family mortgages acquired by the Enterprises. To estimate the magnitude of the state-level differences in average total carrying cost, the estimation assumes that loans originated in each state will default at the national average default rate.

The table below, titled “Estimated Time to Obtain Marketable Title and Cost per Day Relative to the National Average,” provides information on the time periods and costs used to develop the proposed fees. The column titled “Foreclosure Timeline in Days” shows, for each state, the target number of days after the last paid installment on a mortgage for a loan servicer to complete the foreclosure sales process. Those timelines are published in each Enterprise’s servicing guide and are reviewed and updated as necessary every six months. The timelines shown in the column were published in June 2012 at

<https://www.efanniemae.com/sf/guides/ssg/relatedservicinginfo/pdf/foreclosuretimeframes.pdf> and <http://www.freddiemac.com/learn/pdfs/service/exhibit83.pdf>.

The timelines are periods within which Enterprise servicers are expected to complete the foreclosure process for mortgages that did not qualify for loan modification or other loss mitigation alternatives. The timelines are derived from an analysis of the Enterprises’ actual experience with foreclosure processing in each state, adjusted for existing statutory requirements and certain changes in law or practice during the historical period. The published timelines also take into account the effects that foreclosure moratoriums or other extenuating circumstances and lender-specific delays outside the expected norms for that state may have had on actual foreclosure timelines.

Estimated Time to Obtain Marketable Title and Cost per Day Relative to the National Average					
State 1/	Foreclosure Timeline in Days 2/	Estimated Average "Unable-to-Market" Time in Days	Total Time to Obtain Marketable Title in Days	Cost per Day Relative to the National Average 3/	Rank (Total Time * Cost) 4/
AK	300	0	300	93%	11
AL	270	0	270	93%	2
AR	280	0	280	102%	13
AZ	300	0	300	84%	3
CA	300	0	300	90%	7
CO	330	0	330	85%	12
CT	690	0	690	109%	52
DC	300	0	300	86%	5
DE	480	0	480	83%	27
FL	660	0	660	111%	51
GA	270	0	270	101%	9
GU	500	0	500	100%	38
HI	500	90	590	79%	35
IA	480	0	480	110%	42
ID	440	0	440	88%	26
IL	480	60	540	118%	50
IN	480	0	480	107%	40
KS	330	90	420	108%	33
KY	420	30	450	97%	32
LA	390	0	390	106%	29
MA	350	0	350	97%	22
MD	485	120	605	97%	49
ME	570	0	570	95%	44
MI	270	180	450	118%	43
MN	270	180	450	96%	30
MO	270	0	270	109%	17
MS	270	0	270	107%	14
MT	360	0	360	88%	20
NC	300	0	300	91%	10
ND	405	60	465	109%	39
NE	330	0	330	114%	25
NH	270	0	270	110%	18
NJ	750	0	750	113%	53
NM	450	60	510	91%	34
NV	360	0	360	83%	19
NY	820	0	820	112%	54
OH	450	30	480	114%	45
OK	420	0	420	104%	31
OR	330	0	330	88%	16
PA	480	0	480	108%	41
PR	720	0	720	68%	37
RI	330	0	330	107%	23
SC	420	0	420	95%	28
SD	360	180	540	105%	46
TN	270	0	270	96%	6
TX	270	0	270	132%	24
UT	330	0	330	82%	8
VA	270	0	270	87%	1
VI	510	0	510	93%	36
VT	510	30	540	105%	47
WA	330	0	330	88%	15
WI	480	30	510	113%	48
WV	290	0	290	87%	4
WY	270	120	390	86%	21
<b>National Average (UPB Weighted)</b>	<b>396</b>	<b>17</b>	<b>413</b>	<b>100%</b>	

1/ Includes the District of Columbia and certain U.S. territories. The Enterprises do not currently acquire loans in the Northern Mariana Islands or American Samoa.

2/ Foreclosure time frames are available online at: <https://www.efanniemae.com/sf/guides/ssg/relatedservicinginfo/pdf/foreclosuretimeframes.pdf> and <http://www.freddiemac.com/learn/pdfs/service/exhibit83.pdf>.

3/ Cost per day is expressed as an index relative to the UPB-weighted national average, where 100% represents the average cost. It excludes HARP loans.

4/ Rank is a function of the total time to obtain marketable title multiplied by the indexed cost. The product for each state is indicative of the relative total carrying cost upon which FHFA would base its adjustments to upfront fees. "1" represents the lowest-cost area and "54" the highest-cost area.

The column titled “Estimated Average ‘Unable-to-Market’ Time in Days” shows Enterprise estimates of the additional time after the foreclosure sale date in certain states before an Enterprise can begin to market and sell the property. These additional periods of time are often due to a statutorily set post-foreclosure “redemption period” that allows a borrower to redeem or recover the property by paying off the defaulted loan, or are due to other court-mandated procedures that otherwise prevent an Enterprise from marketing and selling the foreclosed property. These time estimates were based on recent Enterprise experience and state law.

The column titled “Total Time to Obtain Marketable Title in Days” provides the sum of the number of days shown in the two preceding columns, which equals the estimated average length of time from the date of the last mortgage payment to the date on which the foreclosed property is eligible to be marketed for sale. Although these times are based on recent data, they do not reflect changes to state laws that have not been in effect long enough to influence the foreclosure timelines published by the Enterprises.

The second factor used in the estimation is the per-day carrying cost incurred by the Enterprises on non-performing loans, which varies across the states. That cost includes property taxes, legal expenses, hazard insurance, costs related to maintenance and property repairs, and the Enterprises’ costs of financing a non-performing mortgage. These costs were estimated using recent data. State and local government decisions can significantly affect the carrying cost per day, especially with respect to property taxes.

The column titled “Cost per Day Relative to the National Average” shows a state-by-state index of estimated per-day carrying costs per dollar of unpaid principal balance,



where the national average equals 100 percent. Those index values were derived from separate estimates from each Enterprise, which FHFA weighted on the basis of the Enterprises' respective market shares in recent years.

The column titled "Rank" shows the total time to obtain marketable title multiplied by the indexed per-day carrying cost. For each state, this product is indicative of the relative total carrying costs upon which the agency would base its adjustments to upfront fees under the planned approach. The states, District of Columbia, and territories are ranked, with "1" representing the lowest-cost area and "54" the highest-cost area.

The first two factors—days to obtain marketable title and per-day carrying costs—provide estimates of the total carrying cost of a defaulted mortgage, by state. The third factor used in the methodology is the expected national average default rate on single-family mortgages acquired by the Enterprises. This was estimated using the national book of business acquired by Fannie Mae and Freddie Mac in the first half of 2012. Since the national average default rate is used in the estimation, the upfront fees that the Enterprises would impose on loans originated in certain states, under FHFA's planned approach, are not affected by any variation that may exist at the state level in the credit quality of loans acquired by the Enterprises, expected future house price movements, or other factors that may affect the likelihood of loan default.

The methodology combines the three factors with appropriate rates of discount to produce present-value estimates of expected total default-related carrying costs for a new mortgage in each state. Those state-level estimates were produced separately by Fannie Mae and Freddie Mac. FHFA weighted each Enterprise's estimates by its respective market share in recent years to produce a single set of estimates. FHFA then calculated

the standard deviation from the mean of the state-level estimates of expected total default-related carrying costs, which was found to be 10 basis points.

The planned approach focuses on the small number of states that have expected total default-related carrying costs that significantly exceed the national average and, thus, cause the greatest increase in average loss given default. Based on current data, loans in five states would be assessed upfront fees. The state between one and one half and two standard deviations from the mean, Illinois, would have an upfront fee of 15 basis points. The states between two and three standard deviations from the mean, Florida, Connecticut, and New Jersey, would have an upfront fee of 20 basis points. The state more than three standard deviations from the mean, New York, would have an upfront fee of 30 basis points.

This approach would allow for variation in practice among the states and impose upfront fees only on those states that are statistical outliers from the rest of the country. If those states were to adjust their laws and requirements sufficiently to move their foreclosure timelines and costs more in line with the national average, the state-level, risk-based fees imposed under the planned approach would be lowered or eliminated. The approach recognizes that each state establishes legal requirements governing foreclosure processing that it judges to be appropriate for its residents. It also recognizes that unusual costs associated with practices outside of the norm in the rest of the country should be borne by the citizens of that particular state rather than absorbed by borrowers in other states or by taxpayers.

#### **Future Changes to State-Level G-Fee Adjustments**

The planned approach bases state-level adjustments to upfront fees on past experience and a limited range of cost variables. FHFA would consider, in the future, changes to its methodology to address additional variables. For example, these could include estimates of the impact of recently-enacted laws and ordinances. Such calculations would be based on experience with similar laws and ordinances and their effects on per-day carrying costs. FHFA could also include a wider range of state actions in its methodology. For example, FHFA could consider state laws and ordinances affecting the disposition of acquired real estate following a default, commonly referred to as real estate owned (REO), and address attendant costs created by state and local rules that impose charges above a certain amount or impose duties that add to the costs of the Enterprises. The Enterprises, therefore, could undertake revisions to their state-level g-fees based on experience gained with additional measurement devices.

### **Input**

FHFA invites input from any person with views on the planned approach and on potential future changes to state-level g-fee adjustments. In particular, FHFA is interested in the following three questions:

1. Is standard deviation a reasonable basis for identifying those states that are significantly more costly than the national average?
2. Should finer distinctions be made between states than the approach described here?
3. Should an upfront fee or an upfront credit be assessed on every state based on its relationship to the national average total carrying cost, such that the net revenue effect on the Enterprises is zero?

FHFA will accept public input through its Office of Policy Analysis and Research (OPAR), no later than [INSERT 60 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER], as the agency moves forward with its deliberations on appropriate action. Communications may be addressed to FHFA OPAR, 400 Seventh Street SW., Ninth Floor, Washington, DC 20024, or emailed to [gfeeinput@fhfa.gov](mailto:gfeeinput@fhfa.gov). Communications to FHFA may be made public and would include any personal information provided.

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